

**FINANCIAL INTERMEDIATION BY NGOS IN THE GAMBIA:
A COMPLEMENT OR A SUBSTITUTE FOR INDIGENOUS
SELF-HELP VILLAGE GROUPS?**

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Abstract

This paper analyzes financial intermediation of two types of NGOs and assesses their complementarity or substitutability for the functions previously performed by indigenous self-help village groups (kafos) in The Gambia. The emergence of NGOs providing village level services is found to be only a partial substitute for the financial functions traditionally performed by these indigenous village groups. Institutional duality is, therefore, observed due to the coexistence of indigenous village groups alongside the NGOs providing multiple services demanded by villagers. The complementarity or substitutability of NGOs for kafos is largely determined by their institutional design for the provision of financial services. NGO programs that provide financial services based on lessons learned from kafos tend to complement rather than substitute for the kafos. The villagers seem better served this way. These findings have implications for any interventions which disrupt but only partially substitute for traditional village arrangements and institutions.

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Indigenous self-help groups need to develop in their own tempo, follow their own rules and preserve their own cultural identity. Any outside interference into them might only work counterproductively -- Frits Bouman.

I. Introduction

Subsaharan African (SSA) countries report a variety of indigenous self-help informal groups at the village level (Bouman).² In The Gambia such groups are called kafos and they are multifunctional, voluntary and usually homogenous in terms of members' age, ethnicity, gender and occupation but have various membership sizes.³ These kafos provide

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² These village groups are called as demisenu tons in Mali, tons in Senegal, and iddir in Ethiopia (Aredo; Dupuy). Similar indigenous village groups are also found under different names in other African countries including Zaire (Slover and Cuevas) and Cameroon (Schrieder and Cuevas).

³ Kafo is a Mandinka word that roughly corresponds to yirde or compin in Fula and morom in Wolof in The Gambia (Shipton).

multiple services that include insurance, financial intermediation, labor exchange, and social and political services (Carney; Shipton).⁴

Kafos traditionally fill in for missing markets by providing several services including financial intermediation. Recently, there has been an emergence of non-governmental organizations (NGOs), frequently linked to international agencies, that are rapidly expanding the scale and scope of their village-level operations. The NGOs that provide only financial intermediation in the villages may, however, either complement or substitute for traditional kafo activities. Depending on whether or not the NGOs are effective complements or substitutes, the kafos may either disappear or may become transformed and coexist with the NGOs. The traditional kafos have an explicit village welfare objective that insures marginal populations. The disappearance or transformation of kafos may spell the end of access to village contingency and welfare funds for these populations. Villagers with more assets, however, may find they are better served by NGOs than they were by traditional kafos. As a result, the overall welfare of the village may be either enhanced or diminished by the NGOs.

The way NGOs design their programs will determine whether or not they complement or substitute for traditional kafo activities. Kafos are customized to suit the requirements of their members and therefore their operational design reveal the preferences of their members. The majority of NGOs operate with heterogenous operational philosophies conceived by their external donors. This has resulted in diverse institutional

⁴ See Nagarajan, Meyer and Ouattara for a discussion on the evolution of kafos in The Gambia.

designs used to provide financial services in villages. Whereas some NGOs design their programs around the *savings first approach*, others follow the classical supply leading *credit first approach*. Furthermore, while some NGOs operate independent of kafos, others try to use kafos (either existing or specifically organized) as conduits to provide financial services (Graham et al).⁵ Consequently, the terms and conditions for the provision of financial services by NGOs may cause positive or negative externality problems. For example, NGOs may provide individual loans from external funds at zero interest rates using the kafos as conduits which disrupts the traditional kafos that usually charge a positive interest rate on loans made from internally mobilized funds. This could cause the villagers to depend on cheap external funds and destroy local savings mobilization.

This paper provides some insights on whether complementing and/or substituting of kafo activities by NGOs leads to *pareto improvement* or to the destruction of traditional structures that worsen the welfare of the village.⁶ Specifically, the paper assesses the implications of NGO institutional designs on welfare in Gambian villages by examining if these NGOs complement or substitute for traditional kafo activities. The analysis is based on a purposive survey of the functions performed by 15 kafos in five villages where two NGOs with different institutional designs are active in The Gambia.

⁵ It has been argued that targeting groups rather than individuals shifts two costs from the financial intermediaries to the borrowers: (i) borrower screening costs, and (ii) monitoring costs thus reducing transaction costs and repayment problems (Stiglitz; Varian). Empirical evidence from developing countries, however, show mixed results in loan repayment performance where groups have been used (Huppi and Feder).

⁶ Pareto improvement is realized if no one is made worse off by making at least one person better off.

II. NGOs and Traditional Village Groups: A Conceptual Discussion of Substitutes and Complements

In general, complementary elements are those that mutually supply each others inability to fill out or complete an activity, while substitutes are those that replace the function of another element in an activity. The ability of an element to *effectively* complement or substitute for another element has consequences for the final outcome of an activity. This section sets the guidelines under which NGOs and traditional village groups complement or substitute for each other and consequently affect the overall welfare of the community.

NGOs typically tend to offer only limited financial services in a village, such as deposit mobilization and/or production loans, compared to the multiple services provided by traditional kafos that include insurance, financial intermediation, labor exchange and social services. While loans from NGOs can function as an insurance substitute, kafos extend individual and aggregate insurance through several mechanisms that include informal savings and contingency credit services, and social relationships that ensure mutual help.⁷ Therefore, the entry of NGOs into rural financial markets might either substitute for or complement all or part of the traditional kafo functions. Furthermore, the use of kafos as conduits for NGO loan programs may induce a shift in the relative importance *within and among the functions* performed by traditional kafos. Consequently, kafos may either disappear entirely due in part to a *darwinian* process of complete substitution or institutional

⁷ See Eswaran and Kotwal for a discussion of role of credit as an insurance mechanism in peasant economies.

duality may occur with the coexistence of kafos and NGOs that together provide all the services demanded by villagers.⁸

The provision of financial services by NGOs, on the one hand, may result in three types of substitution effects: (i) they can cause the disappearance of traditional kafos by completely substituting for all their services, or (ii) they may only substitute for all the financial services provided by the kafos leading to a shift *among* functions as kafos discontinue their financial function, or (iii) they may partially substitute for some of the financial functions of the kafo leading to a shift *within* the set of financial services as the kafos continue only the financial functions not substituted by the NGO. In other words, NGOs will diminish or displace the traditional kafos only if their financial services are perfect substitutes for the financial, insurance and other services provided by a kafo. Otherwise, institutional duality will occur with the coexistence of kafos and NGOs simultaneously providing multiple services because NGOs only represent an incomplete or partial substitute for traditional kafos. For example, if the NGOs provide all types of financial services including deposit services, consumption and production credit at attractive terms and conditions, then kafos may discontinue providing such services and emphasize other services not met by NGOs. This will result in shifts among kafo services. However, if NGOs provide only production credit, then kafos may coexist with NGOs to provide deposit services and consumption credit.

⁸ A darwinian process refers to the elimination of the weakest due to the survival of the fittest.

The provision of financial services by NGOs, on the other hand, may only complement the insurance and financial services of kafos so they continue to perform these functions efficiently. In brief, NGOs may offer deposit services for kafo funds and untargeted credit to the kafo as a group clientele at an attractive interest rate. In this fashion, NGOs also increase their pool of resources through deposits mobilized from kafos. As a result, institutional duality will emerge with the coexistence of NGOs and kafos in the same village but with a healthy symbiotic relationship between the kafos and NGOs resulting in a positive sum welfare game.

The emergence of NGOs as financial intermediaries can provide an efficient alternative financial system to villagers in a country, such as The Gambia, where formal financial institutions provide few services in rural areas. The use of kafos to channel NGO financial services may (i) increase the pool of resources available to the kafos, and (ii) improve loan repayment rates and reduce transaction costs in mobilizing savings for NGOs.⁹ In this way, NGOs and kafos can be complementary in a pareto improving way resulting in a positive sum game. NGOs may also cost effectively substitute for some or all of the kafo financial services leading to more efficient use of kafo resources in alternative services. This may also result in a pareto improvement or at least no welfare loss. Substitution, however, can be counterproductive if NGOs (i) create negative externalities by providing financial

⁹ Rural households, especially women engaged in vegetable farming, often save in small quantities at frequent intervals (Shipton). The transaction costs involved in mobilizing these small but frequent funds on an individual basis are often high for financial intermediaries. A group of savers such as a kafo can, however, collectively deposit a larger amount and thus reduce transaction costs for the financial intermediaries. This will also reduce savers' transaction costs which are high due to high travel costs incurred in going to the nearest bank branch.

services that destroy the carefully built institutional safeguards of the kafos, or (ii) reorient traditional kafo functions of kafos through the deterioration or discontinuation of traditional insurance mechanisms that are especially useful to *marginal populations* but are not offered by the NGOs. In this case, the substituting of kafo functions by NGOs will result in an aggregate welfare loss in the village. Equity considerations which are often the basic principles of kafos are then exchanged for efficiency considerations. Therefore, the substitution of NGOs for kafos may be counterproductive.

The discussion above showed that the net effect of NGOs offering financial services previously provided by traditional kafos can lead either to a positive or negative sum game. The next section tests these postulates in the Gambia.

III. Empirical Evidence from The Gambia

The objective of this research was to examine the implications of provision of financial services by NGOs on the functions of traditional self-help village groups in The Gambia. NGOs began offering financial services in the Gambia in the late 1980s. Presently there are a total of 14 NGOs following diverse approaches in supplying financial services in rural and peri-urban villages (Graham et al.,). We purposely selected for study two NGOs, Centre International de Developpment et de Recherche (CIDR) and Action Aid of the Gambia (AATG), that provide financial services in The Gambia. This was done for two reasons: (i) these NGOs are active in rural areas where the majority of kafos are found, and (ii) the institutional design followed by these NGOs are substantially different to allow for interesting comparisons. Whereas Action Aid is a nationwide program, the CIDR only

provided technical assistance to six villages in the Jahally-Pacharr area to set up village savings and credit associations (VISACAs).¹⁰ We hereafter refer to CIDR as VISACAs and Action Aid, The Gambia as Action Aid. Of these six VISACA villages, five are also serviced by Action Aid. Therefore, we selected a total of five villages for the study where both VISACAs and Action Aid are active. Information was gathered through interviews designed to collect data on kafo activities in the sample villages during February-April of 1993. None of the sample villages was serviced by any formal financial institution, although one village was eligible for production credit from the Gambia Cooperative Union.

i. The Characteristics of the VISACA and Action Aid Programs

Table 1 summarizes the characteristics of the institutional design followed by VISACAs and Action Aid. Action Aid provides subsidized loans to individual members through village kafos using external funds. The CIDR provides only technical assistance in the formation of village banks called Village Savings and Credit Associations (VISACAs) and encourages the village kafos to participate as clients in these savings and credit programs.¹¹ Action Aid does not mobilize local savings since it depends upon external donor funds to provide loans. In sharp contrast, the VISACAs rely almost exclusively on internally generated funds through village savings mobilization to supply loans to individuals and kafos at village determined market rates. Furthermore, while Action Aid supplies loans only for production purposes and for women, the VISACAs do not target any specific loan

¹⁰ See Chapter V in Graham et al., for details about the villages where VISACAs function.

¹¹ See Chapter II in Graham et al. for details on several NGO programs and VISACAs in The Gambia.

purpose or clientele group. The VISACAs are owned and operated by the villagers and the savings and loan services are based on terms and conditions proposed in village wide assemblies. In contrast, the terms and conditions for Action Aid loan programs are set by external donors. Indeed, the institutional design of the VISACAs closely emulates the traditional village kafos. Therefore, the VISACAs can be considered endogenous to the village while Action Aid is an externally imposed institution.

ii. The Sample

Table 2 describes the characteristics of the kafos sampled for the study. A total of 15 kafos in the five sample villages actively engaged in some form of financial intermediation and insurance functions were identified. The survey revealed that the kafos were fairly homogenous in member characteristics. The criteria for membership in the kafos included, in order of priority, geographic proximity, gender, occupation, age and ethnicity. Whereas six of the kafos sampled were comprised of only men and two were comprised of only women, seven were mixed gender. While gender of the leader of a mixed kafo was determined by the majority gender of the members, the members of the management committee were comprised of both genders and were chosen democratically. The activities and bylaws for the provision of kafo services were decided by the members. Therefore, the terms and conditions for the various services including financial services reflects the revealed preferences of the villagers. The kafos were fairly large with an average membership size of 112 members, representing nearly 70 percent of the total adult population of the village. Membership in multiple kafos were common with members participating in 2.8 kafos on average.

Several of the sampled kafos were directly or indirectly assisted by NGOs. Table 3 classifies the kafos based on the degree of participation of NGOs in their activities. While seven of the kafos did not have any direct NGO participation (group I), three were used by Action Aid as conduits for its loans (group II), and three were *created* by Action Aid to provide loans while two others were created by other NGOs to provide grants (group III).¹² Since our objective is to compare the impact of the institutional design of the VISACAs and Action Aid on kafos, we excluded in our analysis the two kafos that were created by other NGOs. The villages in our sample were serviced by both Action Aid and the VISACAs. However, differences exist in their use of kafos. The VISACAs encourage the kafos to become members of their associations in all the sample villages, while Action Aid directly used kafos as conduits for their loans to individual villagers. Therefore, the VISACAs influence kafos by their *presence* while Action Aid influences kafos by its *direct intervention* into kafo operations. The functions performed by the kafos were clearly influenced by the degree of NGO participation in their activities as will be seen in the following section.

iii. Functions of the kafos

The kafos, in general, performed economic activities that included the provision of insurance, credit and savings, labor services and social and political activities. Kafos can be broadly classified into four groups based on their primary functions.¹³

¹² On an average, the kafos in group I and II were 9.5 years old, while group III kafos were 4.5 years old.

¹³ Since functions were usually overlapping, classification is not mutually exclusive as the observations lie along a continuum.

a. Insurance kafos: In general, members of these kafos (women, men or both) cultivated a common plot of groundnuts, cereals or vegetables, or operated common machinery and contributed the proceeds to a common village fund primarily used to mitigate village level contingencies and, to a lesser extent, member contingencies.¹⁴ The terms and conditions for contingency loans varied based on the composition of members and the fund size of a given kafo. Some kafos, especially the large ones, allocated some funds for village level contingencies and divided the rest among themselves instead of supplying loans to members.¹⁵

b. Financial activity kafos: These kafos, in general, undertook savings and credit activities on an organized basis. Savings were mobilized through regular contributions to the savings fund that was usually nonrotating in nature and divided among members at the end of a specified time (ex. ramadan feast). While no interest was paid on funds maintained within the village, kafo funds deposited in the VISACAs and in commercial banks earned interest. Kafo funds were accumulated through the proceeds earned from a common activity, through mobilizing deposits, and through interest earnings from previous contingency loans to members. Considering the labor contributed to common activities as a type of membership fee, the design of these savings and credit kafos resembles that of rudimentary credit unions. Loans to kafo members to meet contingency needs were usually supplied from kafo funds at *a group determined interest rate*. Penalties for non-repayment

¹⁴ The contingencies included medical expences, funerals and fire accidents.

¹⁵ This is rational behavior since the size of a group is inversely proportional to the familiarity and linkages among its members. Therefore, the informational and peer monitoring advantages of group related activities declines with an increase in group size.

of loans included social sanctions against the family of the borrower. Rotating savings and credit associations (ROSCAs) are increasingly found within the kafos as a subset of kafo activities. There were more than one ROSCA within a kafo since the ROSCA membership is limited to small groups of 10-15 members of the kafo.

Kafos that were created and used as conduits by Action Aid had an additional source of funds for member loans from Action Aid. This NGO primarily provided loans in kind to the kafos at a subsidized rate. Kafos used part of the loan for production purposes on their common kafo fields and lent out the rest to their members. The kafos, however, still engaged in organized savings and credit activities to a limited extent to supplement the NGO funds and provide contingency loans to members.

c. Labor kafos: These were mutual aid kafos primarily organized to mobilize labor during periods of peak demand. The labor usually rotated among the member farms to take advantage of seasonal variations and water availability on specific plots. Some labor kafos also performed insurance functions for their members by supplying contingency loans from kafo funds. Kafo funds were accumulated through the proceeds generated from cultivation of a common plot.

d. Social and political kafos: These kafos were temporary in nature and were usually used to organize social activities (ex. soccer club) or political rallies. While they collected contributions (one-time/periodic) from their members to cover their costs, they were not directly involved in credit and savings activities.

Based on the above classification, the activities of the kafos before and after the entry of NGOs into the villages are presented in Table 4. The first important observation is that

the traditional kafos in Group I and II did not disappear with the entry of NGOs into the villages but continued to coexist with them and continued to perform various activities. This indicates that the financial services of the NGOs did not fully substitute for all of the kafo activities. Secondly, there has been an increase in financial activities, especially ROSCA activities, in all three types of kafos from the time of their origin. This is markedly significant in kafos belonging to Group III. Although the increase in financial activities by kafos indicates increased monetization in these areas, the increase in Group II and III kafos indicates that kafos need to coexist with the NGOs to provide the full range of financial services demanded by villagers. In other words, the targeted production loans from Action Aid only partially satisfied the demand for financial services by the villagers. Kafos are necessary to fill in the demand for contingency credit and savings services for its members.

While the kafos in Group I and II have reduced their insurance functions, the kafos in Group III have increased these insurance functions from the time of their origin. In order to further understand the reasons behind this observation, we examined the various functions performed by kafos and NGOs in the sample villages before and after the entry of NGOs (Table 5). While the Group I and II type kafos were the primary source of financial and insurance services, NGOs have become an alternative financial network in the sample villages. Note that the VISACAs are the only NGO that participates with Group I kafos. Therefore, the decrease in insurance functions performed by Group I kafos can be explained by the ability of the VISACAs to substitute in part for the insurance functions performed by these kafos. This also partly explains the data in Table 4 that shows a decrease in the total number of activities performed by group I kafos from 23 to 18 from

the time of their origin. These observations underscore the importance of untargeted credit provided by VISACAs that can be used for consumption smoothing as an insurance substitute by the villagers.

Furthermore, Table 4 also shows that the total number of activities in Group III kafos have increased from the time of their inception. This increase in their activities is due to the increase in insurance and financial functions performed by these kafos. Table 5 indicates that Action Aid and the VISACAs jointly provide financial services with Group III kafos in the sample villages. These observations again show that financial services by Action Aid are only a partial substitute for kafo services. Since Action Aid provided only production loans, the group III kafos need to incorporate insurance functions into their activities to serve aggregate and member level contingencies. Also since Action Aid did not mobilize deposits, the kafos incorporated savings mechanisms through ROSCAs and non-rotating savings and credit associations into their functions. As a result, group III kafos that were principally created to function as conduits for Action Aid and provide only financial services were transformed into multi-activity kafos with an emphasis on additional financial and insurance functions. These observations point out that the financial services of Action Aid only partially substitute for kafo functions and only partially satisfy the demand for a range of financial services in the villages.

IV. Financial Intermediation by NGOs: Are they Complements or Substitutes for Kafos?

The above discussion shows that the financial services of both VISACAs and Action Aid only partially substitute for the traditional kafo functions and that financial services are

only one of the services demanded by the villagers. The discussion also indicates that the different operational approaches employed by these NGOs influence their degree of substitution for traditional village kafo services. To test this hypothesis, we need to identify NGO institutional forms: (i) one that can effectively substitute for and expand the range of services of traditional kafos resulting in pareto improvement, i.e., a positive sum game, (ii) one that does not effectively substitute for kafo services but in a pareto optimal framework worsen the welfare of the village, i.e., a negative sum game, and (iii) one that complement the functions of the kafos resulting in a pareto improvement, ie., in positive sum game. Next, we examine the implications of different institutional designs of the VISACAs and Action Aid for the supply of services to kafos and the villages in which they are located.

i. VISACAs and Kafos

Although the VISACAs do not use kafos as conduits for providing financial services, they encourage kafos to become client-members and participate in savings and credit activities. Our interviews with kafo heads revealed that:

****** Prior to creation of the VISACAs, the common kafo funds were either left idle with the treasurer until some need arose, were immediately given out as loans to the members or were equally divided among the members to prevent their misuse by the treasurer. This led to indiscriminate loans to members based on a 'first come first served basis' since the funds had to be quickly disbursed. This resulted in an inefficient use of common funds. With the formation of the VISACAs, nine out of 13 kafos in the sample deposit their common funds in these associations. In addition

to safety, their term deposits earn interest and their current deposits can be quickly withdrawn to meet kafo needs.

**** Membership in the VISACAs allows kafos to obtain loans that augment their funds to provide better services to the community. For example, one of the kafos had to repair its machinery but the common funds were not sufficient. Therefore, it obtained a loan from the VISACA to augment its common fund and repaired the machine.**

**** Kafo deposits increase the pool of resources available to the VISACAs for contingent on-lending services to the community. This leads to a more efficient use of kafo funds at a lesser cost to the kafos. Otherwise, kafos would need to directly provide all loans which involves transaction costs related to screening, monitoring and enforcing loan contracts.**

**** Previously, kafos did not insist on collateral, and provided loans to their members at arbitrarily fixed rates based on the availability of funds. Kafos are now more cautious in their lending activities, insist on some form of collateral, and only meet the demand unmet by the VISACAs. In short, the kafos have learned these practices from the VISACAs.**

**** The VISACAs do not target clients, loan uses or enterprises. As a result, the number of borrowers from the kafo funds has declined with the kafos only offering**

emergency loans to kafo borrowers who cannot access VISACA loans at their higher interest rates.¹⁶

The VISACAs generate substantial wealth and value added in the community through the expansion of a growing number of individual income generation activities stimulated through loans. On average, three month VISACA loans to female traders generated 25 to 720% net profits for their client-borrowers depending on the activities financed (CIDR). The majority of the VISACA client-borrowers deposit their surpluses in the VISACAs which in turn enable the VISACAs to provide more loans. Kafos also use the VISACAs to deposit their own common funds and provide loans to their members who cannot access loans from VISACAs, especially the poorer kafo members. Both the VISACAs and kafos function at the same time complementing each other in a healthy symbiotic fashion. The above observations highlights how VISACAs complement the kafos in their villages strongly implying an improvement in village welfare.

Alternatively, the VISACAs substitute for some kafo functions as an alternative financial network in the villages. This is evident from the reported decline in the number of borrowers from the kafos. However, VISACAs are more directed towards individuals than to groups within the village. The growth of the VISACAs may come at the expense of contributions to kafos due to the shift from *collective risk sharing* practiced in kafos to *individual risk management* followed by their members in the VISACAs. Consequently, this will reduce the supply of kafo funds and the access of the marginal populations to village

¹⁶ The reasons for non accessibility to VISACA loans may be due to lack of collateral, a short fall in the VISACA funds, and the limited number of days the VISACAs are able to service clients. They are only open once a week.

contingency and insurance funds. In other words, if some kafo member contributors choose to drop out of their kafos or reduce their kafo contributions because of their increased accessibility to VISACA financial services, then the size of available kafo funds will decline. It is true that the asset rich and able bodied members of the kafos will have better access to VISACA services than marginal members of the kafos. In this case, the VISACAs substituting for the financial and insurance services provided by the kafos could result in a worsening of welfare for the marginal members of the kafos. It is relevant to note, however, that traditional kafos coexist with the VISACAs and continue to provide insurance and financial functions to marginal members who lack access to VISACAs. This strongly suggests that VISACAs are not perfect or complete substitutes for the range of financial services supplied by kafos but are only substitutes for a subset of these services (loans and savings) and that there is likely no loss in aggregate village welfare.

It is difficult to conclude if VISACAs substitute or complement the kafos. Indeed, the VISACAs both complement and partially substitute for kafo services, but the net effect is a likely pareto improvement in village welfare. This indicates that an NGO design that does not directly interfere into the kafo activities but gives great flexibility for the villagers to define their own arrangements, provides untargeted financial services and is based on the principles of kafos serves the community in a positive way.

ii. Action Aid and Kafos

Our earlier discussion showed that the financial services provided by Action Aid only partially substituted for the traditional financial activities of the kafos so they continued to

coexist with Action Aid to provide all the financial services demanded by villagers. Our interviews with kafo heads revealed that:

****** In kind loans issued by Action Aid to the kafos were often inadequate to meet all member needs. Therefore, loan quantity rationing existed in which loan applicants were rejected completely along with loan size rationing where borrowers were provided with smaller sized loans than demanded. Some smaller kafos, however, divided equally among their members the total quantity of inputs provided by Action Aid.

****** Loans were provided to kafos by Action Aid at a zero to 12 percent annual interest rate, considerably below the kafo and VISACA rates. The kafos, in general, passed on this interest subsidy to their borrowers. Kafos that use their own funds to provide member loans, however, charged a 20-25% annual interest rate while VISACAs charged 40-60 percent.

****** No collateral except for group liability was required for loans provided by Action Aid.

****** Since Action Aid targets women and prefers lending to women kafos, two women kafos were *created* out of the existing kafo to obtain the loans. However, the loans were not used by the women since few women purchase chemical fertilizers and pesticides for use in their coarse grain production. Instead, the loans were diverted to men in the original kafo who then frequently defaulted on loan repayments.

Action Aid was not very strict in its loan enforcement mechanisms. Therefore, repayment rates for Action Aid loans were less than 42 percent. This is in sharp contrast to the 90-95 percent repayment rates observed with loans provided through kafos and VISACAs. Also, Action Aid funds for loans to kafo members came from external sources at a subsidized rate. There is no doubt that the additional funds from an external source at a subsidized rate increased the pool of resources available to the community. However, the institutional design based on external help, subsidies and a credit first approach creates a negative externality in the community. For example, the kafos work together and mobilize deposits to build a common fund which is used to provide loans to their members. Institutional safeguards are devised to screen and monitor borrowers and enforce loan contracts through collective efforts of the kafo. A donor virus can erode these carefully built institutional safeguards of the traditional kafos with respect to loan repayment and savings behavior. The poor loan recovery that characterizes the Action Aid loan portfolio could begin to contaminate the kafo loan activity. Furthermore, kafos may become increasingly dependent on external and subsidized assistance. In the worst case scenario, kafos might discontinue their insurance and financial services. This would have a negative impact on the marginal kafo members in the village. Also, if the current low loan repayment continues, Action Aid may discontinue its assistance to the villages. With the demise of the kafos, the village will then be left without any alternative insurance and financial mechanism until it incurs the transaction costs of rebuilding its kafo. Thus the partial substitution of Action Aid for kafo financial services through its current operational approach results in a negative sum game and worsens the aggregate welfare of the

community. This might appear to be an overly romanticized interpretation of the implications of Action Aid on the kafos and welfare of the village. But, it highlights the long-term dynamic issues that arise from NGOs that intervene in rural communities with externally defined financial programs.

V. Conclusions and Policy Implications

Kafos have traditionally provided a variety of services including insurance, financial intermediation, labor services and social and political services in Gambian villages. Recently, NGOs have expanded rapidly into villages and are now providing financial services. They follow diverse institutional designs in the provision of financial services including use of traditional kafos as conduits. This expansion of NGOs into rural areas and use of kafos can have implications for traditional village self-help groups and the services they provide villagers, especially the marginal kafo members. Consequently, the aggregate welfare of the village may be enhanced or undermined by NGO presence and intervention into traditional kafo activities. This study attempted to address this issue.

The study shows that the financial services provided by both VISACAs and Action Aid complement kafos to a certain extent but are only partial substitutes for kafo activities. Marginal members of kafos are, however, not directly serviced by both VISACAs and Action Aid. Nonetheless, the non intervention policy of the VISACAs into kafo activities and their untargeted loans provided from locally mobilized deposits at village determined interest rates are likely to produce a positive benefits for kafos. The aggregate welfare of the village is likely to increase or at least remain unaffected. In contrast, the targeted loans from

Action Aid at subsidized interest rates using external funds seem to negatively influence kafos by eroding their carefully built institutional safeguards. As a result, the Action Aid program, in addition to only partially substituting for kafo activities, lowers the aggregate village welfare. It may be presumptuous at this stage to conclude which of the various NGO institutional designs is ideal for The Gambia ensuring that aggregate village welfare could be increased unambiguously. Nonetheless, we can conclude from the above discussions that the VISACAs are preferable to the Action Aid program in our sample villages. In other words VISACAs pareto dominates the Action Aid programs.¹⁷

The obvious policy implication is that an externally defined institution that directly intervenes into traditional village structures with rudimentary financial technology is pareto inferior to a non interfering institution that complements traditional village kafos. NGOs should take care such that the use of informal traditional groups as conduits to channel external donor funds do not damage the roots of these traditional systems (Cuevas).

¹⁷ Both VISACAs and Action Aid function in the same sample villages with possible interaction effects on one another and kafos. Therefore, this study is limited by its inability to effectively separate the *presence effect* of the VISACAs from the *intervention effect* of the Action Aid. Nonetheless, the results of the study are robust enough for policy implications.

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Table 1. Operational Characteristics of Selected NGO Designs in Providing Financial Services in The Gambia.

Items	NGOs	
	AATG ^a	VISACAs ^b
<u>1. Status</u>	Intl.	Hybrid
<u>2. Sponsors</u>	UK ^c	CIDR/KFW ^d
<u>3. Organizational design features</u>		
a. Operational philosophy	Encourage income generating activities and local organizations	Provide unsubsidized financial services
b. Source of funds for financial services	External	All local savings
c. Financial services offered	Credit, Compulsory savings	Credit and Savings
d. Geographic coverage	Rural	Rural
e. Target clientele	Women and Farmers	Untargeted
f. Mode of reaching clientele	Mostly kafo groups and some Individuals	Mostly individuals and some kafo groups
g. Target enterprise	Agri.	Untargeted
<u>4. Terms and conditions and instruments used</u>		
a. Principal Type of loans	Short term, In-kind loans	Short term, cash loans
b. Type of saving accounts	Compulsory fixed deposit held in central office	Current and fixed deposits held in local units
c. Loan int.rate (%/yr)	0-12	40-60
d. Savings int.rate (%/yr)	0	20-40
e. Collateral	Group liability	Animals, farm implements and jewelry
<u>5. Subsidy component</u>		
a. External technical assistance	High	Moderate
b. Operational costs	High	None
a.	AATG: Action Aid, The Gambia	
b.	VISACA: Village Savings and Credit Associations	
c.	UK: United Kingdom	
d.	CIDR/KFW: Centre International de Developpment et de Rechesche/Kreditanstalt fur Wiederaufbau	

Table 2. Sample Villages, Kafos and NGOs present in the Sampled Villages.

<u>Particulars</u>	
No. of Sample Villages	5
NGOs present	Action Aid, CIDR, Catholic Relief Services
No. of sample Kafos	15
Male kafos	6
Female kafos	2
Mixed gender kafos	7
<u>Kafo Characteristics</u>	
Average membership size	112
Average number of activities	3.1
Average number of kafos participated per member	2.8
<u>Membership Criteria for the Kafos (percent of kafos reporting)</u>	
by Geographic proximity	85
by Gender and occupation	62
by Age and Ethnicity	30

Table 3. Sample Kafos Classified by Degree of NGO Involvement in Kafo Activities

Particulars	Kafo Types			Total
	Group I ^a	Group II ^b	Group III ^c	
Male kafos	3	1	2	6
Female kafos	0	0	1	1
Mixed gender kafos	4	2	0	6
Total	7	3	3	13

- a. Group I kafos do not have any direct involvement with NGOs.
- b. Group II kafos are used as conduits by Action Aid
- c. Group III kafos were created by Action Aid to function as its conduits.

Table 4. **Kafo Activities Before and After the NGO Entry and Involvement in Kafo Activities**

Particulars	Kafo Types					
	Group I ^a		Group II ^b		Group III ^c	
	Original ^d	Current ^e	Original	Current ^t	Original	Current
Sample Size (No. of kafos)	7	7	3	3	3	3
<u>Kafo Activities</u> (No. of kafos reporting)						
Insurance	7	4	3	2	2	3
Labor	5	2	2	3	2	2
Financial	6	7	2	3	0	4
Non-rotating savings and credit	5	5	2	2	0	2
ROSCAs	1	2	0	2	0	2
Social and Political	5	5	2	2	1	2
Total No. of activities ^f	23	18	9	10	5	11

a. Group I kafos do not have any direct involvement with NGOs.

b. Group II kafos are used as conduits by Action Aid

c. Group III kafos were created by Action Aid to function as its conduits.

d. Original refers to the time when the kafos were originally created.

e. Current refers to the status in 1993.

f. Numbers will not add up to sample size due to multiple activities reported by the kafos.

Table 5. Functions Performed by Kafos and NGOs in Sample Villages

Kafo Groups	Functions			
	Insurance	Labor	Financial	Social and Political
Group I^a				
Original ^b	Kafo	Kafo	Kafo	Kafo
Current ^c	Kafo	Kafo	Kafo and VISACA	Kafo
Group II^d				
Original	Kafo	Kafo	Kafo	Kafo
Current	Kafo	Kafo	Kafo, Action Aid, VISACA	Kafo
Group III^e				
Original	Kafo	Kafo	Action Aid	Kafo
Current	Kafo	Kafo	Kafo, Action Aid, VISACA	Kafo

- a. Group I kafos do not have any direct involvement with NGOs.
- b. Original refers to the time when the kafos were originally created.
- c. Current refers to the status in 1993.
- d. Group II kafos are used as conduits by Action Aid
- e. Group III kafos were created by Action Aid to function as its conduits.

